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No. 76-1138

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In the Supreme Court of the United States

OCTOBER TERM, 1976

LE BEAU TOURS INTER-AMERICA, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. McCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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The question presented in this federal income tax case is whether petitioner derived 95 percent or more of its gross income from "sources without the United States" within the meaning of Section 921 of the Internal Revenue Code of 1954 (26 U.S.C.). The courts below found that it had not and that it therefore failed to qualify for the special tax benefits of a Western Hemisphere trade corporation.

The pertinent facts are as follows: Petitioner was organized in 1966 by the owners of Le Beau Tours, Inc. ("Tours") with a view toward qualifying it as a Western Hemisphere trade corporation within the meaning of Section 921 of the Code. The organizers hoped to transfer certain of Tours' activities to petitioner and thereby

obtain the benefit of the special Section 922 tax deduction for Western Hemisphere trade corporations. Petitioner thereafter developed and sold package tours to Central and South America, offering to United States tourists certain hotel, local transportation, and guide services. Those services were performed by various independent contractors with whom petitioner had contracted, rather than by petitioner's employees (Pet. App. A2, A6).

In most instances, petitioner acted as a wholesale travel agent, marketing its services through retail travel agents in the United States. Petitioner's customers paid for hotel and other foreign services at the general retail rate in United States currency in New York. Petitioner withheld its commissions from its customers' payments and remitted only the balance to the foreign hotel or ground operators. Its New York office was in Tours' office and members of Tours' New York-based staff performed petitioner's bookkeeping and other clerical work. Petitioner paid Tours nearly 30 percent (\$74,259) of its gross income of \$260,000 for those services in 1966 and an even greater percentage of its gross income during 1967 and 1968. Petitioner stipulated that its work force (including those employed by Tours, but performing petitioner's work and exclusive of its foreign independent contractors) spent more than 5 percent of its working hours in New York (Pet. App. A2, A7, A12-A13).

On audit, the Commissioner of Internal Revenue determined that petitioner did not qualify as a Western Hemisphere trade corporation. In this refund suit brought by petitioner in the United States District Court for the Southern District of New York, the district court held that petitioner did not qualify as a Western Hemisphere trade corporation because it derived more than 5 percent of its income from sources within the United States

(Pet. App. A5-A13). The court of appeals affirmed *per curiam* (Pet. App. A1-A4).

1. Section 921 of the Internal Revenue Code of 1954 prescribes three conditions for qualification by a domestic corporation as a Western Hemisphere trade corporation. It must (1) conduct its business exclusively in the Western Hemisphere; (2) derive 95 percent or more of its gross income for the three-year period immediately prior to the close of the taxable year from "sources without the United States"; and (3) derive 90 percent or more of its gross income from the active conduct of a trade or business.¹

The courts below correctly held that petitioner did not derive 95 percent of its gross income from sources outside the United States and therefore did not qualify as a Western Hemisphere trade corporation. To the contrary, petitioner simply provided a service to customers in the United States, and it performed this service in large part within the United States. In addition to arranging the packages of hotel accommodations, local transportation and guide services abroad, petitioner promoted its tour packages within the United States, procured customers in the United States, collected payment from its customers in advance of their travel, and transmitted payment from the United States to the foreign enterprises. Petitioner, or Tours on its behalf, also performed day-to-day administrative activities within the United States as an integral part of its operation.

Since compensation for services performed within the United States is income from sources within the United

¹Section 1052(b) of the Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1520, 1647-1648, provides for a gradual reduction and eventual repeal by the end of 1980 of the benefits accorded to Western Hemisphere trade corporations.

States (Section 861(a)(3)), more than 95 percent of petitioner's income was not derived from sources outside the United States.²

Petitioner conceded below (Pet. 5) that more than 5 percent of the total time expended by its officers and by Tours' personnel performing work related to petitioner's activities was spent in New York. Under the applicable Regulations (Treasury Regulations on Income Tax, Sections 1.861-4(b)(2) and 1.921-1(c), Appendix, *infra*), the determination whether income from the performance of personal services was derived from within or from without the United States depends upon the amount of time spent within and without the United States performing the work. *Tipton and Kalmbach, Inc. v. United States*, 480 F. 2d 1118 (C.A. 10). Since petitioner acknowledged that more than 5 percent of the time spent by the personnel responsible for its business successes was spent within the United States, it did not derive 95 percent or more of its gross income from sources outside the United States.³

²Petitioner (Pet. 6-7) relies upon *Frank v. International Canadian Corp.*, 308 F. 2d 520 (C.A. 9); *Commissioner v. Hammond Organ Western Export Corp.*, 327 F. 2d 964 (C.A. 7); *Baldwin-Lima-Hamilton Corp. v. United States*, 435 F. 2d 182 (C.A. 7); and *Commissioner v. Pfaudler Inter-American Corp.*, 330 F. 2d 471 (C.A. 2). But those cases involved income that domestic corporations derived from sales of goods that were completed outside of the United States and was thereby derived from sources outside of the United States. See Section 862(a)(6). Here, however, petitioner's sole function was to render services, most of which it performed in the United States.

³Contrary to petitioner's contention (Pet. 7-10), neither *Commissioner v. Piedras Negras Broadcasting Co.*, 127 F. 2d 260 (C.A. 5), nor *Commissioner v. East Coast Oil Co.*, 85 F. 2d 322 (C.A. 5), conflicts with the decision below. In *Piedras Negras*, virtually all significant services performed by the taxpayer were performed in Mexico. Likewise, in *East Coast Oil Co.*, the sale of the oil products occurred outside of the United States.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. McCREE, JR.,
Solicitor General.

APRIL 1977.

APPENDIX

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§1.861-4 Compensation for labor or personal services.

* * * * *

(b) Amount includable in gross income—* * *

(2) *Taxable years beginning before January 1, 1976.* If a specific amount is paid for labor or personal services performed in the United States, that amount (if income from sources within the United States) shall be included in the gross income. If no accurate allocation or segregation of compensation for labor or personal services performed in the United States can be made, or when such labor or service is performed partly within and partly without the United States, the amount to be included in the gross income shall be determined by an apportionment on the time basis; that is, there shall be included in the gross income an amount which bears the same relation to the total compensation as the number of days of performance of the labor or services within the United States bears to the total number of days of performance of labor or services for which the payment is made.

* * * * *

§1.921-1 Definition of Western Hemisphere trade corporation.

* * * * *

(c) *Statement required.* * * * The gross income from sources within the United States and without the United States shall be determined as provided in Part I (section 861 and following), subchapter N, chapter 1 of the Code, and the regulations thereunder.